

How Risky are Your Rewards?

Jonathan Chapman

Pay and rewards frequently account for some thirty five percent or more of total costs in an organisation. Ever since the collapse of Northern Rock in 2007 much political, media and practitioner interest has been given to the issue of reward management. This debate has focussed on the role reward structures were perceived to have played in causing excessive risk taking in the financial services industry and the role this risk taking played in the problems that still continue in that sector. However research by the Chartered Institute for Personnel and Development and Cranfield School of Management has identified that the focus on the financial services sector was potentially distracting attention from a much wider collection of reward risks that need managing across all sectors.

Call to action

The research, which was composed of a survey of 285 reward practitioners, two workshops and interviews with a range of reward and risk management professionals, showed that organisations needed to improve their reward risk management through proactively identifying, assessing and then appropriately managing key risks arising from their reward strategies, rather than what was generally seen to be the case, reacting to problems after they had occurred.

Some help

To help organisations improve their reward risk management the research defined seven reward risk groups and a series of reward specific risk management tools to help organisations structure their risk identification and risk mitigation work. The key risk groups that organisations need to consider, along with illustrative quotes of what participants said about them, when examining their reward risk situation were:

Strategic risk - Risk arising from the misalignment of reward strategy to the organisation's goals. This risk can lead to the inability to attract and retain the employees needed for success.

“there is little awareness or understanding of reward concepts throughout the business. This is impacting on the ability to introduce new ways or rewarding to help deliver a changing business strategy”

Behavioural risk - Risk arising from the misalignment of reward strategy to the required employee behaviours. This risk can lead to the rewarding of inappropriate or unproductive organisational activity and behaviour.

“We have the operational risks under control. The focus has to be on the behavioural risks arising from our reward work. The risk that our reward structures do not promote and support the right behaviour is paramount”

Financial risk - Risk arising from inadequate reward cost management. This risk can lead to poor value for money and, where relevant, lower profitability or even loss.

“The key concerns are the ability of the company to sustain the payroll bill. With the rise in cost of providing benefits such as health care and a tight labour market”

Operational risk - Risk arising from the poor execution or failure of reward systems and reward processes. This risk can lead to inefficiency or inaccuracy of the systems or fraud in their operation.

“HR and payroll system capability continues to be a high impact risk with high likelihood. Investment in place for 2010 but risks continue to increase during the period”

Implementation and change management risk - Risk arising from poor implementation or change to the reward strategy and / or processes. This risk can mean that the reward strategy is managed ineffectively and therefore does not have the required impact.

“The danger is that we will rest on our laurels and fail to move policy forward in the window of opportunity which the economic downturn is providing”

Legal and ethical risk - Risk arising from non compliance with organisational and societal values and legal and regulatory reward requirements. This risk can lead to employee claims or regulatory action which can have financial and reputational effects on the organisation.

“Too much poorly drafted and ill-thought out government legislation”

Governance risk - Risk arising from inadequate oversight and challenge to organisational reward strategy. This risk can lead to inappropriate reward policies being pursued.

“There is a real risk of over-regulation in top executive remuneration (baby and bathwater syndrome) which makes the remuneration committee’s role even more difficult”

Effective reward risk management

In order to proactively manage your reward risks you need to:

1. Establish effective reward risk intelligence-gathering systems.
2. Proactively review your reward strategy and systems for risk.
3. Use established risk management tools to assess and manage identified reward risks.
4. Know your reward risk appetite and manage risk consistent with this.
5. Build your risk management capability and develop a permanent risk management culture.

Whilst a framework can help to structure risk identification, it will only be useful if adopted in a culture where risk management is seen as a key organisational skill. This requires both HR professionals and line managers to work together to identify the main reward risks that threaten the organisation’s business strategy. However this may not be as daunting as it sounds. Most organisations already have a risk management system by which key risks are identified and managed across the organisation. Effective reward risk management was seen at a number of organisations where the HR team had tapped into the wider process and were using it as an effective means of

raising and dealing with significant reward related risk in all of the risk groups outlined above.

Will your reward approach propel you forward or hold you back and pull your organisation down? In these uncertain times, when agility and sustainability are key, it is important to know how you stack up against identified reward risk factors.

The report and the associated reward risk management tools can be downloaded from

http://www.cipd.co.uk/subjects/pay/general/_managing_reward_risks.htm?lsSrchRes=1

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